(3)



No. 91-2045

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1992

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R. GORDON DARBY, *et al.*,
*Petitioners,*

v.

JACK KEMP, *et al.*,
*Respondents.*

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**On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit**

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## JOINT APPENDIX

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**PETITION FOR CERTIORARI FILED JUNE 18, 1992**
**CERTIORARI GRANTED NOVEMBER 2, 1992**

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The following opinions, decisions, judgments, and orders have been omitted in printing this joint appendix because they appear on the following pages in the appendix to the printed Petition for Certiorari:

## CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

May 31, 1990—Plaintiff Darby's complaint filed in U.S. District Court for the District of South Carolina, Charleston Division.

May 31, 1990—Plaintiff's motion for preliminary injunction filed.

July 2, 1990—Defendant Kemp's motion to dismiss for failure to exhaust administrative remedies filed.

September 13, 1990—Hearing on defendant's motion to dismiss and plaintiff's motion for preliminary injunction.

September 27, 1990—Plaintiff's motion for summary judgment filed.

October 17, 1990—Defendant Kemp's cross motion for summary judgment filed.

October 29, 1990—Order entered denying defendant's motion to dismiss and denying plaintiff's motion for preliminary injunction.

November 9, 1990—Defendant's answer filed.

December 18, 1990—Hearing on cross motions for summary judgment.

April 10, 1991—Order entered granting plaintiff's motion for summary judgment and denying defendant's motion for summary judgment.

June 4, 1991—Defendant's notice of appeal filed.

February 26, 1992—Opinion and judgment of the Court of Appeals for the Fourth Circuit.

March 11, 1992—Appellee Darby's petition for rehearing, with suggestion for rehearing in banc, filed.

March 20, 1992—Order entered denying petition for rehearing and suggestion for rehearing in banc.

UNITED STATES DISTRICT COURT
FOR DISTRICT OF SOUTH CAROLINA

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Civil Action No. 2-90-1184-18

R. GORDON DARBY, DARBY DEVELOPMENT COMPANY, DARBY REALTY COMPANY, DARBY MANAGEMENT COMPANY, INC., MD INVESTMENT, PARKBROOK ACRES ASSOCIATES, and PARKBROOK DEVELOPERS,
*Plaintiffs*,

v.

HONORABLE JACK KEMP, Secretary of U.S. Department of Housing and Urban Development, 451 7th Street, S.W., Room No. 10000, Washington, D.C. 20410,

C. AUSTIN FITTS, Assistant Secretary for Housing/FHA, Commissioner, 451 7th Street, S.W., Room No. 9100, Washington, D.C. 20410,

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, 451 7th Street, S.W., Room No. 10266, Washington, D.C. 20410,

and

THE UNITED STATES OF AMERICA,
*Defendants.*

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**COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF**

[Filed May 31, 1990]

## PRELIMINARY STATEMENT

1. This action, seeking injunctive and declaratory relief from defendants' unlawful debarment of plaintiffs, arises under the Due Process Clause of the Fifth Amend-



ment to the United States Constitution and under the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 551 *et seq.*, and §§ 701, *et seq.* The Department of Housing and Urban Development ("HUD") has sanctioned plaintiff R. Gordon Darby with a one-year Limited Denial of Participation ("LDP") and has debarred Mr. Darby and his affiliate companies and partnerships for 18 months based on Mr. Darby's actions during 1982-1983 in participating in a HUD-insured financing program that was used extensively in South Carolina with the knowledge and approval of HUD.

2. HUD imposed these sanctions notwithstanding the conclusions of its own Administrative Law Judge ("ALJ") that (a) Mr. Darby, who has spent 28 years in the real estate business, enjoys an excellent reputation for truth and veracity and has consistently demonstrated "exemplary performance as a builder and manager of housing projects"; (b) the financing program in issue was not designed to fail; (c) Mr. Darby did not participate in the program to cheat the government out of money; and (d) although HUD mortgage insurance was obtained through the wrong program, there was no intent to deceive HUD, and Mr. Darby did not defraud HUD. Moreover, HUD purports to sanction Mr. Darby as an irresponsible government contractor despite undisputed evidence that the financing program it now finds to have been improper was contemporaneously disclosed to and approved by HUD, itself.

3. In sanctioning the plaintiffs under these circumstances, defendants committed the following violations of the Constitution, the APA, and HUD's own regulations, 24 C.F.R. Part 24, which require that the LDP and the debarments be set aside:

a. Defendants' conclusions that Mr. Darby engaged in misconduct are not supported by substantial evidence

in the record, and are otherwise arbitrary, capricious, and not in accordance with law.

b. Defendants erroneously concluded that HUD was not estopped from sanctioning plaintiffs based on its prior approval of the financing program which Mr. Darby utilized, thereby violating plaintiff's constitutional right to due process of law and his statutory rights under the APA.

c. Defendants acted in an arbitrary and capricious manner by debarring plaintiffs yet failing to similarly sanction their own officials who approved plaintiffs' conduct.

d. Defendants' conclusion that Mr. Darby engaged in misconduct by failing to exercise "prudent business judgment" on two occasions in 1982 and 1983, even if correct, does not rationally support a conclusion that he lacks present responsibility as a government contractor in light of the undisputed evidence of his integrity, his "exemplary performance as a builder and manager of housing projects," and the fact that the alleged misconduct in 1982-1983 is now incapable of repetition.

e. Defendants' rationale for debarring plaintiffs—to deter Mr. Darby and others from acting similarly in the future—is contrary to law because it constitutes forbidden punishment of a contractor for perceived past misdeeds rather than protecting the government from a contractor who is not presently responsible.

4. Plaintiff seeks entry of a judgment setting aside the LDP and debarments and declaring such actions to have been taken in violation of the Fifth Amendment guarantee of due process and to have been arbitrary, capricious, unsupported by substantial evidence, an abuse of discretion and not in accordance with law, in violation of the APA. Plaintiff also seeks entry of appropriate preliminary and permanent injunctions to redress the



continuing irreparable injury he is suffering from defendants' unlawful actions.

## PARTIES

5. Plaintiff R. Gordon Darby resides in Charleston, South Carolina.

6. Plaintiffs Darby Development Company, Inc., Darby Realty Company, Darby Management Company, Inc., MD Investment, Parkbrook Acres Associates, and Parkbrook Developers are all companies or partnerships owned by R. Gordon Darby or in which he has an interest, and all are "affiliates" of Mr. Darby within the meaning of 24 C.F.R. § 24.105 and 24.325.

7. Defendant Kemp is the Secretary of the Department of Housing and Urban Development and is sued in his official capacity.

8. Defendant Fitts is the Assistant Secretary for Housing and FHA Commissioner for the Department of Housing and Urban Development, and is sued in her official capacity.

9. Defendant United States issued the debarment through defendant Department of Housing and Urban Development, located in Washington, D.C.

## JURISDICTION

10. This Court has jurisdiction of this action under 28 U.S.C. §§ 1331, 1346, and 2201. Venue in this case is based on 28 U.S.C. § 1391(e).

11. This action arises under the Due Process Clause of the Fifth Amendment of the Constitution, the Administrative Procedure Act (APA), as amended, 5 U.S.C. §§ 551, *et seq.*, and 701, *et seq.*, and the Office of the Secretary, Housing and Urban Development debarment regulations, 24 C.F.R. Part 24.

## PROCEDURAL HISTORY

12. HUD issued a one-year LDP against Mr. Darby on June 19, 1989. Following an administrative conference regarding this sanction, HUD affirmed the LDP by letter dated July 11, 1989. Mr. Darby appealed the LDP on July 21, 1989 (HUDALJ 89-1373-DB (LDP)).

13. Thereafter, by notice dated August 23, 1989, HUD proposed to debar all plaintiffs—Mr. Darby and his affiliates—for a period of five years, based on the same underlying facts and circumstances that gave rise to the LDP. On August 28, 1989, HUD filed a formal Complaint seeking plaintiffs' debarment. (HUDALJ 89-1387-DB). Plaintiffs timely requested a hearing and filed an Answer on October 20, 1989. By letter dated November 16, 1989, HUD amended its Complaint and sought to increase the length of the proposed debarment to an indefinite period.

14. The LDP appeal and the debarment action were consolidated for hearing. A four-day evidentiary hearing was conducted before HUD Administrative Law Judge ("ALJ") William Cregar on December 19-22, 1989, in Charleston, South Carolina. That hearing was transcribed and a transcript has been prepared.

15. Following the hearing, both parties filed briefs and the ALJ took the case under advisement. On April 13, 1990, the ALJ issued a written "Initial Decision and Order" [the "HUD Decision"] upholding the LDP and concluding that good cause exists to debar plaintiffs for a period of 18 months. The ALJ concluded that the LDP and debarment were warranted because of Mr. Darby's actions during 1982-1983 in participating in the HUD single family mortgage loan program. The other plaintiffs were debarred based solely on their status as affiliates of Mr. Darby. A copy of the HUD Decision is attached hereto as Exhibit 1. The hearing transcript, exhibits, pleadings, and the HUD Decision form the administrative record in this case.



16. No discretionary review of the ALJ's decision and order was sought from defendant Kemp by either party. Accordingly, the ALJ's decision and order became final on April 29, 1990, and plaintiffs have exhausted their administrative remedies.

## FACTUAL AVERMENTS

### A. *The Mid-South Financing Program*

17. The financing program that HUD has now found improper was not originated by Mr. Darby, but instead was devised by a mortgage banker and recognized expert in HUD financing, Lonnie Garvin, Jr., who was then the President of Mid-South Mortgage Company ("Mid-South"), an FHA-approved mortgage then located in Aiken, South Carolina.

18. Mr. Garvin's plan was devised during 1981 in an environment of high inflation and high interest rates that had drastically slowed new housing construction and produced a pent-up demand for rental housing in South Carolina. Mr. Garvin's plan was to utilize HUD's single family mortgage insurance program to build units that would initially be marketed as rental housing and later, when interest rates dropped, could be sold off as single family units. Mr. Garvin recognized that, during the initial years, there would be a negative cash flow on the units because rents could not be set high enough to cover the debt service. Accordingly, the plan envisioned that the units would be owned by limited partnerships, which would cover the operating deficits in return for tax write-offs for the limited partner investors, and which would eventually make a profit when economic conditions turned more favorable and permitted the units to be sold off or refinanced.

19. Mr. Garvin's plan envisioned the use of HUD-insured mortgage loans obtained pursuant to the single family mortgage insurance program, section 203(b) of

the National Housing Act, 12 U.S.C. § 1709(b), to provide permanent financing on the housing units. The HUD-insured mortgage loans would be used to refinance or "take out" the short-term construction loans utilized to build the housing units. Indeed, Mr. Garvin would not obtain construction financing and commence building the units until he had a commitment from HUD to insure the permanent mortgage loans upon the completion of construction.

20. Mr. Garvin perceived that the major issue he faced in trying to structure this financing program was the so-called Rule of Seven, a HUD regulation which made rental properties ineligible for single family insurance if the mortgagor already had financial interests in seven or more similar rental properties in the same project or subdivision. 24 C.F.R. § 203.42(a). The project that Mr. Garvin envisioned building would consist of 30 units.

21. Accordingly, in mid-1981, Mr. Garvin went to the HUD field office in Columbia, South Carolina, to outline his plan and obtain HUD's interpretation of the Rule of Seven. Mr. Garvin spoke to two senior HUD officials who were in charge of administering the single family program in South Carolina, Henry Granat, Deputy Director for Housing Development, and Robert DesChamps, Chief of the Mortgage Credit Branch. Mr. Garvin was advised by these HUD officials that the Rule of Seven would be satisfied if the units in the project were divided up so that any one borrower had an interest in no more than seven units at the time of loan closing.

22. Relying on the interpretation of the Rule of Seven provided to him by HUD, Mr. Garvin refined his financing plan and took the other steps necessary to prepare for the project he sought to build, a development named Plantation Ridge. He secured options on building lots, and submitted construction plans and specifications to the HUD Columbia office for approval. After applications for the HUD mortgage insurance were prepared, Mr.



Garvin met again with Messrs. Granat and DesChamps in November 1981. Mr. Garvin explained that (a) he was proposing the construction of a project consisting of more than seven units; (b) in order to comply with the Rule of Seven, the applications for the mortgage loans and the HUD insurance thereon would be made in the names of various Mid-South employees, each of whom would hold title to no more than seven properties; and (c) following the closing of the mortgage loans and the issuance of the HUD mortgage insurance, title to the properties would be transferred to a single limited partnership which would rent the properties and cover the operating deficits.

23. Mr. DesChamps, at the direction of Mr. Granat and in the presence of Mr. Garvin, called HUD headquarters in Washington, D.C. for advice regarding the acceptability of Mr. Garvin's plan. He spoke with Ruth Studer, a recognized expert in issues regarding the single family mortgage credit programs, and the national "point person" for questions from HUD field offices regarding the application of the Rule of Seven. Mr. DesChamps described the proposed transaction to Ms. Studer. She advised Mr. DesChamps that Mr. Garvin's financing arrangement would not violate HUD program requirements.

24. The applications for mortgage insurance submitted by the Mid-South employees regarding the Plantation Ridge project indicated in Block 9(a) that the purpose of the mortgage loans was "refinance" because the loans were to be used as permanent financing to replace the construction loans actually used to build the project. This answer and all other answers provided on the applications were fair and reasonable, and made honestly and in good faith.

25. Because the mortgage loans were refinance transactions, the so-called "minimum investment requirement," 24 C.F.R. § 203.19, did not apply in determining the maximum permissible loan amount. Instead, the loan

amounts were based on appraisals of the properties performed by HUD appraisers as part of the HUD approval process and were limited by a separate regulation that set essentially the same ceilings as the minimum investment requirement. HUD Handbook 4000.2 Rev-1, ¶¶ 2-6, 2-7, 2-11 (April 1982).

26. Fully aware of Mr. Garvin's financing plan and the role to be played by the Mid-South employees, HUD approved the Plantation Ridge applications and issued insurance on the mortgage loans for that project.

27. Subsequently Mr. Garvin used this same financing approach for other housing projects he developed—obtaining HUD-insured single family mortgage loans to refinance construction loans on the projects, and satisfying the Rule of Seven by dividing up the housing units in the project for purposes of obtaining the insured loans, following which the units were consolidated in a single owner ("the Mid-South financing program"). Between 1981 and 1984, Mid-South processed approximately 1050 applications through the HUD Columbia office and developed over 1600 housing units using this same financing approach. Most of these applications were processed by Charles Bennett, a HUD employee who worked under the supervision of Mr. DesChamps. There was no attempt by Mid-South to conceal either the nature or the number of these transactions. Indeed, Mr. Bennett kept track of the transfers of title to and from the various Mid-South employees who served as the mortgage insurance applicants, in order to ensure that no one applicant held title to more than seven properties at a time.

B. *The Darby Transactions.*

28. Mr. Darby was involved in utilizing the Mid-South financing program on only two occasions, both of which occurred in the latter half of 1982, approximately a year after Mr. Garvin had instituted the program. In utilizing the Mid-South approach, Mr. Darby reasonably



relied upon the assurance of Mr. Garvin that HUD had approved this financing program, and upon the fact that HUD had already approved over 160 loan transactions that were predicated upon this financing program.

29. One of the two occasions on which Mr. Darby was involved in the use of the Mid-South financing program was with regard to a project named Parkbrook Acres. Mr. Garvin was Mr. Darby's partner in developing this project, and it was he who supervised the development of the project and the securing of the HUD-insured financing. The development, financing, and syndication of Parkbrook Acres followed the pattern Mr. Garvin had initiated with the Plantation Ridge project. Mr. Darby did not prepare any of the mortgage insurance applications relating to the Parkbrook Area project, nor did he serve as the applicant for any of the mortgage loans.

30. The second occasion involving Mr. Darby's participation in the Mid-South financing program related to two projects named Bay Tree and Oakfield. Unlike Parkbrook Acres, these projects had already been constructed and had outstanding construtions loans at the time HUD-insured mortgages were sought. Further, Mr. Garvin played no role in the development of these projects. In addition, the Baytree and Oakfield properties were not transferred to a limited partnership after the mortgage loans were closed. Instead, they were transferred to Darby Development Company, which operated them as rental properties. Finally, Mr. Darby personally acted as the loan applicant with respect to seven units on these properties.

31. The mortgage insurance applications submitted to HUD with respect to Parkbrook Acres, Bay Tree, and Oakfield essentially followed the same pattern used on other Mid-South transactions. The answers provided on those applications were fair and reasonable, and made honestly and in good faith.

C. *HUD's Change of Position.*

32. The applications relating to Parkbrook Acres, Bay Tree, and Oakfield were duly approved by HUD. The mortgage loans were closed and the mortgages were insured by HUD against default.

33. At some point in early 1983, certain HUD Columbia officials, including Mr. Granat, became concerned about the volume of properties being processed pursuant to the Mid-South financing program. Mr. Granat asked his section chiefs to review the correctness of their approval of the applications and was advised by them that everything was in order. Just to make sure, Mr. DesChamps again contacted Ms. Studer at HUD headquarters on March 30, 1983. Mr. DesChamps explained in detail to Ms. Studer the workings of the Mid-South program, and again was advised that applicable program requirements were being satisfied.

34. In the fall of 1983, the HUD Columbia office again contacted HUD headquarters to review the acceptability of the Mid-South financing program. This contact was done by means of a memorandum dated August 30, 1983, addressed to the Acting Assistant Secretary for Housing. His reply, dated September 23, 1983, stated that the Mid-South program was "unacceptable." This was the first time that any official at HUD had indicated disapproval of the Mid-South financing program. By this time, the HUD-insured mortgage loans for Mr. Darby's projects at Parkbrook Acres, Bay Tree, and Oakfield had long since closed. Upon receipt of this communication, the HUD Columbia office stopped the approval of any new applications but continued to process and insure 53 properties for which it had already issued conditional commitments to Mid-South.

D. *The Defaults and HUD's Response.*

35. In 1986, due to market forces beyond the control of Mr. Darby and Mr. Garvin, the mortgage loans secured through the Mid-South financing program went into



default. Over the next two-and-a-half years, Messrs. Darby and Garvin made herculean efforts to work out their financial dilemma with HUD and thereby avoid foreclosure and consequent claims for the mortgage insurance. These efforts were all ultimately rejected by HUD for various reasons. In October 1988, Messrs. Garvin and Darby tendered deeds on the properties to HUD in lieu of foreclosure. HUD, in turn, paid substantial insurance claims to the mortgage holders.

36. Mr. Darby has an excellent business reputation in the Charleston community. Until this case, he has never been threatened with stanctions. Other than the three projects at Parkbrook Acres, Baytree, and Oakfield, he has never defaulted on any mortgage loan. His performance as a builder and manager of housing projects has been exemplary.

37. A HUD audit of the Mid-South loan transactions was initiated in the fall of 1986 and was conducted contemporaneously with the workout negotiations. The purpose of the audit was to discover if there had been any wrongdoing. The audit report concluded that there had been no wrongdoing on the part of either Mr. Garvin or Mr. Darby, and that neither the HUD Columbia office nor HUD headquarters had been misled.

38. Certain individuals in HUD thereafter sought to instigate criminal prosecutions, but the United States Attorney's Office for the District of South Carolina declined to bring any such prosecutions. The United States Attorney's Office concluded that there was no evidence of any intent to commit a crime on the part of the loan applicants or Mid-Souh. Instead "[t]he intent was to take advantage of a financing situation allowed by HUD officials for projects not feasible for conventional financing." HUD Decision, p. 22.

39. Nonetheless, HUD proceeded unilaterally to impose sanctions on certain selected persons involved in

using or approving the Mid-South financing program. On June 19, 1989, HUD imposed one year LDPs on Mr. Darby, Mr. Garvin, certain former Mid-South employees who had acted as the loan applicants/borrowers, and the four HUD Columbia officials who had been involved in approving the Mid-South loan applications: Messrs. Granat, DesChamps, Franklin Corley, and Bennett (all of whom are now retired from HUD). However, HUD never sought to sanction Ruth Studer, the Washington headquarters employee and national expert on single family mortgage credit programs, who had twice advised HUD Columbia that the Mid-South program was acceptable. Although several of the HUD Columbia employees protested the imposition of LDPs against them, HUD refused to modify any except in the case of Corley, whose LDP was reduced to three months.

40. Following the imposition of the LDP sanctions, the South Carolina press reported extensively on the Mid-South loan origination cases. One Columbia newspaper, the State, carried an editorial during the week of August 14, 1989, headlined: "S.C. MORTGAGE RIPOFF IS LATEST HUD SCANDAL." Noting that HUD had imposed LDP sanctions against Mr. Garvin and fourteen others, the article stated, "[b]ut the punishment—a prohibition against doing HUD-related business in this state for a year—is hardly more than a tap on the wrist. HUD officials in Washington can—and should—extend the sanctions nationwide for up to ten years." The HUD Regional Office in Atlanta received this editorial and shortly thereafter, on August 23, 1989, HUD proposed the debarment of Mr. Darby for a period of five years. Subsequently, HUD sought to extend the term of the proposed debarment was increased to an indefinite period. HUD likewise sought the indefinite debarment of Mr. Garvin. (That matter is still pending before the ALJ and is currently scheduled for hearing on August 13, 1990). HUD has not, however, sought to debar any of its own employees.



41. Congress and HUD have since changed the single family mortgage insurance program to eliminate any participation by investors. Thus, the Mid-South financing program could not be replicated today under any circumstances.

E. *The HUD Decision.*

42. In upholding the LDP of Mr. Darby and deciding to debar plaintiffs, the ALJ concluded that the Mid-South financing program was a sham which improperly circumvented the Rule of Seven. He further concluded that false statements had been made on the mortgage insurance applications in order to effectuate the sham. In particular, he concluded that the transactions were falsely characterized as "refinances," thereby permitting the evasion of the minimum investment requirements. HUD Decision, p. 24.

43. Insofar as Mr. Darby was concerned, the ALJ concluded that, notwithstanding HUD's approval of the Mid-South financing program, Mr. Darby "knew or should have known that it was improper." HUD Decision, pp. 25, 32. Although Mr. Darby did not intend to deceive or defraud HUD and although his personal honesty and integrity were not implicated in his use of the Mid-South financing program, the ALJ concluded that, "by blindly following Mr. Garvin's financing program, [Mr. Darby's] exercise of prudent business judgment has been called into question." HUD Decision, p. 37. The ALJ's ultimate conclusion was that "[a] debarment of some length is warranted to impress upon [Mr. Darby] that he must act prudently when dealing with the government and to send a message to those who deal with the government that they, too, must act prudently in similar circumstances." *Id.*

44. The ALJ rejected plaintiffs' defense that HUD was estopped from imposing sanctions because HUD had approved the Mid-South financing program. The ALJ ruled

that Mr. Darby's reliance on the representations made by HUD regarding the permissibility of the Mid-South program was unreasonable. Mr. Darby, the ALJ held, "cannot hide behind the fact that government employees approved the program when he, in the first instance, knew or should have known that it was improper." HUD Decision, p. 32.

F. *The Injury Suffered by Plaintiffs.*

45. The debarments preclude plaintiffs from receiving or participating in government contracts and from participating in any HUD programs. Under its terms, government agencies are prohibited from soliciting bids or proposals from, awarding contracts to, renewing or otherwise extending existing contracts, or consenting to subcontracts with plaintiffs, unless the acquiring agency's head or designee determines that there is a compelling reason for such action. Plaintiffs are also excluded from doing business with the government as an agent or representative of other contractors. Plaintiffs' debarment is effective throughout the Executive Branch of the United States Government and results in plaintiffs' inclusion on the "List of Parties Excluded From Procurement and Non-Procurement Programs."

46. The LDP imposed on Mr. Darby and the debarments imposed on all of the plaintiffs have caused and will cause them substantial and irreparable injury for which there is no adequate remedy at law. These sanctions unfairly and unlawfully stigmatize and punish plaintiffs, cause economic injury to plaintiffs, and deprive plaintiffs of their constitutionally-protected liberty interest in remaining eligible to contract with the government.

47. Seventy-five percent of the business income of Mr. Darby and Darby Development Company derives from government contracts or programs. These plaintiffs have already been deprived of the opportunity to receive award of one large contract by the issuance of the LDP in June



1989 and thereby suffered the loss of over $500,000 of income. In addition, Darby Development Company (of which Mr. Darby is the sole owner) has property management contracts on five different HUD-insured multifamily properties that expire during the course of 1990 and would otherwise be renewed. HUD will not allow these contracts to be renewed until after the debarment period expires in December 1990, thus depriving plaintiffs of $92,280 in management fees that would otherwise have been earned. Plaintiffs also face the loss of $25,875 in Housing Assistance payments under a Section 8 HUD contract that expires in September 1990 and which would otherwise be renewed but for the debarment.

COUNT I

Violation of the APA—Legally Erroneous
Conclusion that Plaintiffs Committed Misconduct

48. Plaintiffs incorporate the allegations of paragraphs 1 through 47 as if set forth fully herein.

49. HUD's conclusion that Mr. Darby knew or should have known that the Mid-South financing program was improper is devoid of support, both factually and legally. HUD's conclusion that false statements were made on the mortgage insurance applications is likewise devoid of support. Further, since the loan transactions were properly characterized as "refinances," the minimum investment requirements were not applicable and there is no basis for faulting Mr. Darby for not complying with those requirements.

50. HUD's legal conclusion that Mr. Darby willfully and materially violated statutory and regulatory provisions and program requirements is not supported by substantial evidence in the record, and is otherwise arbitrary, capricious, and not in accordance with law. The LDP and debarment imposed on Mr. Darby by defendants are therefore contrary to law.

51. Since the other plaintiffs were barred solely on their status as affiliates of Mr. Darby, their debarments likewise are contrary to law.

## COUNT II

### Constitutional Violation—Defendants' Imposition of Sanctions Against Plaintiffs Deprives Them of Due Process of Law

52. Plaintiff hereby incorporates the allegations of paragraphs 1 through 51 as if set forth fully herein.

53. On the facts presented in this case, the constitutional guarantee of Due Process prevents HUD from sanctioning plaintiffs for conduct which it had previously approved. The sanctions deprive plaintiffs of protected liberty interests in violation of their rights under the Fifth Amendment to the Constitution.

## COUNT III

### Violation of the APA—Defendants' Erroneous Rejection of Plaintiffs' Estoppel Defense

54. Plaintiffs hereby incorporate the allegations of paragraphs 1 through 53 as if set forth fully herein.

55. HUD's legal conclusion that it was not estopped from sanctioning plaintiffs because Mr. Darby could not reasonably have relied on HUD's approval of the Mid-South financing program is not supported by substantial evidence in the record, and is otherwise arbitrary, capricious and not in accordance with law. The LDP and debarment imposed on Mr. Darby by defendants are therefore contrary to law.

56. Since the other plaintiffs were debarred based solely on their status as affiliates of Mr. Darby, their debarments likewise are contrary to law.



## COUNT IV

### Violation of the APA—Arbitrary And Unlawful Sanctioning of Plaintiffs

57. Plaintiffs hereby incorporate the allegations of paragraphs 1 through 56 as if set forth fully herein.

58. Defendants acted in an arbitrary and capricious manner by debarring plaintiffs yet failing to similarly sanction their own officials who approved plaintiffs' conduct and had even greater reason to know whether it was permissible under applicable regulatory provisions. Therefore, the debarments imposed upon plaintiffs by defendants are arbitrary and capricious, in violation of the APA.

## COUNT V

### Violation of the APA—Arbitrary and Irrational Conclusion That Plaintiffs Are Not Presently Responsible Government Contractors

59. Plaintiffs hereby incorporate the allegations of paragraphs 1 through 58 as if set forth fully herein.

60. Defendants' conclusion that Mr. Darby engaged in misconduct by failing to exercise "prudent business judgment" on two occasions in 1982 and 1983, even if correct, does not rationally support a conclusion that he and his affiliates are not presently responsible government contractors or program participants in light of the minimal culpability involved in the misconduct, the substantial passage of time since those alleged lapses, Mr. Darby's excellent business reputation, his exemplary record of performance as a builder and manager of housing projects, and the fact that there is no danger whatsoever of the alleged misconduct being repeated. Therefore, the sanctions imposed upon plaintiffs by defendants are arbitrary and capricious, and contrary to law.

## COUNT VI

### Violation of the APA—Unlawful Debarment of Plaintiffs For Purposes of Deterrence

61. Plaintiffs hereby incorporate the allegations of paragraphs 1 through 60 as if set forth fully herein.

62. HUD's debarment regulations forbid imposing debarment for purposes of punishment and permit debarment only for the purpose of protecting the public interest. 24 C.F.R. § 24.115.

63. Defendants' rationale for debarring plaintiffs—to deter Mr. Darby and others from engaging in similar conduct in the future—ignores Mr. Darby's present responsibility as a government contractor and program participant and amounts to punishment for perceived past misdeeds in violation of HUD's own regulation. Accordingly, the debarment of plaintiffs is arbitrary, capricious, and contrary to law.

WHEREFORE, plaintiffs respectfully request entry of a judgment or other form of order:

A. Setting aside the LDP imposed on Mr. Darby and the debarments imposed on all plaintiffs;

B. Declaring the LDP and debarments to have been contrary to law, and to have violated plaintiffs' rights under the Fifth Amendment to the United States Constiution and under the APA;

C. Directing defendants not to place plaintiffs' names on, or in the alternative, to remove plaintiffs' names forthwith from, all compilations of those ineligible to participate in HUD programs or receive an award of government contracts, including, but not limited to, the "List of Parties Excluded From Procurement and Non-Procurement Programs";

D. Granting preliminary and permanent injunctive relief enjoining defendants from taking any action to exclude plaintiffs from government contracting or any HUD programs based upon Mr. Darby's participation in the Mid-South financing program in 1982 and 1983;



E. Awarding plaintiffs their costs, disbursements and reasonable attorneys fees in this action; and

G. Granting such other relief as is just and proper.

Respectfully submitted,

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DATED: May 31, 1990

EXHIBIT 1

**INITIAL DECISION AND ORDER**

(Issued by the ALJ on April 13, 1990)

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[The "Initial Decision and Order" has already been filed in the case as Appendix D to the "Petition for a Writ of Certiorari."]



IN THE DISTRICT COURT OF UNITED STATES
FOR DISTRICT OF SOUTH CAROLINA
CHARLESTON DIVISION

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Civil Action No. 2-90-1184-18

R. GORDON DARBY, *et al.*,
*Plaintiffs*

v.

HONORABLE JACK KEMP, *et al.*,
*Defendants.*

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**GOVERNMENT'S ANSWER TO PLAINTIFFS COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF**

The Defendants herein respectfully submit their answer to Plaintiffs' Complaint in the above-captioned case, calling to the attention of the Court and incorporating herein by reference the April 13, 1990 Decision and Order by Administrative Law Judge William C. Cregar and Defendants' Memorandum in Support of Defendants' Motion for Summary Judgment and Response to Plaintiffs' Motion for Summary Judgment filed with the Court October 17, 1990, as follows:

1. The first sentence of paragraph 1 of Plaintiffs' Complaint is a conclusion of law to which an answer is not required; to the extent an answer is required, it is denied. As to the second sentence, Defendants deny that the financing "program" or scheme employed by Plaintiffs was used with Defendants' knowledge or approval, but admit the remaining averments of the sentence.

2. The first sentence of paragraph 2 is denied insofar as it implies there were insufficient facts to support the

decision of the Administrative Law Judge. The second sentence is also denied, insofar as it alleges the Mid-South financing plan was disclosed to and approved by HUD.

3. Denied.

4. Denied.

5. Admitted.

6. Admitted.

7. Admitted.

8. Admitted.

9. Admitted.

10. The allegations of paragraph 10 are conclusions of law to which an answer is not required; to the extent an answer is required, the allegations are denied.

11. Denied.

12. Admitted.

13. Admitted.

14. Admitted.

15. Admitted.

16. The Government admits to the first sentence and admits the Administrative Law Judge's decision dated April 13, 1990 became final after 15 days following plaintiffs' failure to seek discretionary review by the Secretary. The government denies plaintiffs have exhausted their administrative remedies.

17. Admitted.

18. The Government admits that the allegations in paragraph 18 are supported in the Administrative Law Judge's findings on pages 3 and 4 of his Order and defers to the Administrative Law Judge's decision.



19. The Government admits to the allegations in paragraph 19, but refers the Court to the Administrative Law Judge's findings on pages 25 and 26 of the Order that the transactions were *not* refinance transactions.

20. The Government admits that the allegations in paragraph 20 are supported in the Administrative Law Judge's findings on pages 5 through 8 of the Order and refers the Court to these pages.

21. The Government admits that the allegations in paragraph 21 are supported in the Administrative Law Judge's findings on page 8 of the Order.

22. The Government denies the first sentence in paragraph 22. The Government is without sufficient information to form a belief as to the truth of the second sentence and therefore denies the same. The Government admits that the remaining allegations in paragraph 22 are supported in the Administrative Law Judge's findings on page 11 of the Order, and refers the Court to the additional findings by the Administrative Law Judge with regard to Messrs. Granat and DesChamps at the November 1981 meeting.

23. The Government admits that the allegations in the first and second sentences in paragraph 23 are supported by the Administrative Law Judge's findings on page 11 of the Order. The Government denies the allegations in the remaining sentences because, as the Administrative Law Judge found at pages 11 and 12 of his Order, Ms. Studer gave advice "[b]ased upon the description of the transaction she was given" by Mr. DesChamps.

24. Defendants admit that the applications for HUD insurance, in the names of Mid-South employees as straw-buyers, include the representation that the purpose of the loans was to "refinance," but deny the remaining allegations of this paragraph.

25. Denied.

26. Denied.

27. The Government admits that the allegations in paragraph 27 are supported, in part, by the Administrative Law Judge's findings on page 13 of the Order. Defendants deny that Mr. Garvin "was satisfying the rule of seven," as characterized in the first sentence of paragraph 27, because he was, instead, circumventing this rule as found by the Administrative Law Judge at page 24.

28. The Government denies the allegation that Mr. Darby used Garvin's "financing program on only two occasions," as Darby used the "program" or scheme to obtain FHA mortgage insurance on approximately 92 properties containing 144 units. The Government denies the second sentence.

29. Admitted, except that the Government denies it was one of two occasions.

30. Admitted, except that the Government denies there were only two occasions.

31. Defendants admit the first sentence; Defendants deny as to the second sentence.

32. Admitted, except the Government denies that the approvals were "duly" granted by HUD.

33. Admitted, except the Government denies that Mr. DesChamps explained in detail to Ms. Studer the workings of the Mid-South program."

34. The Government denies the first sentence in that the Columbia office contacted HUD headquarters not to review the acceptability of the "Mid-South financing program" but to review a *proposal* of the "program." The Government admits to the next two sentences. The Government is without sufficient knowledge to either admit or deny the allegations of the fourth sentence that it was the first time a HUD official "indicated" disapproval; but the Government admits this was the first written request



for approval and, therefore, the first written disapproval. As to the fifth sentence, the Government alleges that the Bay Tree and Oakfield properties had been closed approximately seven months prior to the written disapproval, but admits to the rest of this sentence and the last sentence.

35. The Government denies the first sentence, and alleges the mortgage loans "went into default" because mortgagors failed or refused to make their mortgage payments. The Government disagrees with the characterization that the efforts of Messrs. Darby and Garvin were "herculean" or that their motives were limited to avoiding foreclosure and insurance claims. The remainder of the paragraph is admitted.

36. The Government is without sufficient knowledge to either admit or deny this paragraph, and defers to the findings of the Administrative Law Judge.

37. Admit that the allegations of this paragraph are supported by the ALJ's findings at page 22.

38. Admit that the allegations of this paragraph are supported by the ALJ's findings at page 22.

39. Admitted.

40. Admitted, except that as to the fifth sentence the attorneys for the Government are without sufficient information either admit or deny that the HUD Regional Office received the editorial and therefore it is denied. Further, the Defendants deny the implication that publicity caused the Defendants to propose debarment of Plaintiffs.

41. The first sentence is admitted. The Government admits an exact replication of the Mid-South financing scheme would not receive approval today.

42. Admitted.

43. The United States admits the ALJ made the conclusions alleged in this paragraph.

44. Admitted.

45. Admitted.

46. On information and belief Mr. Darby and his affiliated companies are capable of conducting business with non-government entities and accordingly the United States denies the allegations of this paragraph.

47. Denied.

48. The Government's answer to paragraph 1 through 47 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

49. Denied.

50. Denied.

51. Denied.

52. The Government's answers to paragraphs 1 through 51 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

53. Denied.

54. The Government's answers to paragraphs 1 through 53 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

55. Denied.

56. Denied.

57. The Government's answers to paragraphs 1 through 56 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

58. Denied.

59. The Government's answers to paragraphs 1 through 58 of Plaintiffs' Complaint are hereby adopted by reference just as if they are fully set forth herein.

60. Denied.



61. The Government's answers to paragraphs 1 through 60 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

62. Admitted.

63. Denied.

64. Further answering Plaintiffs' Complaint all averments not specifically admitted, are hereby denied and strict proof thereof is hereby demanded.

Government's Affirmative Defense

1. Plaintiffs have failed to state a cause of action upon which relief can be granted.

2. Plaintiffs have failed to exhaust their administrative remedies.

3. Plaintiffs' Complaint as to the request for relief from the Limited Denial of Participation is moot.

WHEREFORE, Defendants having fully answered the Complaint pray that the Court will dismiss the Complaint and grant costs to the Defendants herein.

Respectfully submitted,

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